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SUBJECT: EUROPE FINANCIAL AND ECONOMIC REPORT:
29th, 2009

May

FINANCIAL SERVICES: UPCOMING ISSUES /EVENTS

ECOFIN to discuss EU financial supervision:

¶1. (SBU) On June 9, ECOFIN will meet in Luxembourg to discuss the Commission's proposals to reform financial supervision in the EU. The Commission seeks approval of the proposals by Finance Ministers ahead of the European Council on June 18-19. Ministers will also continue to discuss concerns about growing divergences in U.S. and EU accounting standards, after last month's ECOFIN asked the Commission for further analysis.

Commission unveiled proposals to set up macro-prudential and micro-prudential supervisory bodies, turn current supervisory committees into agencies:

¶2. (SBU) On May 27, the European Commission presented its formal proposal for reforming Europe's system of financial supervision. The proposal, which is open for comment until July 15, calls for the creation of a European Systemic Risk Council (ESRC), chaired by the European Central Bank, to monitor and recommend action to tackle systemic risks and a European System of Financial Supervisors (ESFS), which would integrate three new pan-EU Authorities for banking, insurance and securities markets supervision with national supervisors. The ESFS would be given power to issue binding technical standards and interpretative guidelines and to settle disagreements between national supervisors. The UK is opposed to the ESRC being permanently chaired by the ECB and would prefer a rotating chair. Others, such as the Chairman of the Basel Committee on Banking Supervision (BCBS) Nout Wellink, have criticized the proposal for not addressing the question of burden sharing in banking crises, which he advocates should be legally binding. Mr. Wellink noted that the current composition of the ESRC is too unbalanced towards central banks.

Parent firms of Romanian and Hungarian banks agree to support subsidiaries:

¶3. (SBU) In a coordination meeting in Brussels of the European Banking Group held on May 19, the parent banks of the nine largest foreign banks incorporated in Romania (Erste Group Bank, Raiffeisen International, Eurobank EFG, National Bank of Greece, Unicredit Group, Societe Generale, Alpha Bank, Volksbank, Piraeus Bank) reaffirmed their commitment to support their Romanian subsidiaries. The parent banks of the six largest foreign banks in Hungary (Bayerische Landesbank, Erste Group Bank AG, Intesa SanPaolo, KBC Group, Raiffeisen International Bank Holding and UniCredit Bank Austria AG) also made a joint declaration committing to maintain their overall exposure to the country and to ensure prudent capitalization of their subsidiaries. The European Banking Group Coordination Meetings (for Romania and for Hungary) were jointly chaired by the European ommission and the IMF.

Almunia calls for E banks to be stress tested:

14. (SBU) On May 25, European Commissioner for Economic and Financial Affairs Joaquín Almunia forcefully advocated that European banks be subjected to stress tests on a Europe-wide level. Almunia urged the private sector to participate in recapitalizing the banks, but for this to happen transparency is critical to convince private capital to invest in financial institutions, whose outstanding capital needs have been estimated by Credit Suisse at 84bn. The U.S. favors widespread stress tests to remain at the current level of 0.5%.

European elections:

16. (SBU) From June 4 to June 8 the EU will elect the European Parliament. Election day varies according to custom from country

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to country. Polls have generally predicted a low turnout amid widespread lack of interest in the European Parliament's activities. A January Eurobarometer poll found that only 34% of voters intended to vote, but a recent (May 26) EU-wide poll found that 43% of respondents said they were certain to vote and a further 6% said they were very likely to do so. Political outcomes are difficult to predict, as they play more to national than to EU issues.

RECENT EVENTS:

Swedish Finance Minister Anders Borg sees financial reforms a priority:

17. (SBU) Swedish Finance Minister Anders Borg, who will preside over the ECOFIN Council from July to December, said that Sweden will give priority to financial reforms during its Presidency, and in particular the de Larosière report, despite opposition from the UK and Germany.

S&P warns of downgrade UK sovereign debt:

18. (SBU) On May 21, Standard & Poor's warned of a possible downgrade of the UK's sovereign debt, given the UK's debt-to-GDP forecasted ratio of 100%. According to S&P, such high levels of debt are not consistent with a AAA rating. The FT reports that France and Germany may also be subject to a credit downgrade, given the evolution of their debt levels

March construction output and industrial new orders down:

19. (SBU) In March 2009, construction output was down by 1.0% in the euro area and by 2.1% in the EU27, compared with February 2009, when it declined by 0.6% and 0.2% respectively. Year-on-year, the decline is 8.7% and 10.5%, respectively. The industrial new orders index for March was also down by 0.8% in the euro area and by 0.7% in the EU27. Year-on-year industrial new orders decreased by 26.9% in the euro area, and by 25.5% in the EU27.

Euro area May 2009 inflation estimated at 0.0%:

110. (SBU) Euro area annual inflation is expected to be 0.0% in May 2009 according to an estimate issued on May 29 by Eurostat. It was 0.6% in April.

German Unemployment rate falls slightly in May:

111. (SBU) The unemployment rate fell from 8.3% of the workforce in April, to 8.2% in May.

ESI and BCI continue their recovery:

¶12. (SBU) The Economic Sentiment Index (ESI), which is regarded as a guide to future trends in activity, has risen for a second consecutive month in May, gaining 2.1 points in the euro area and 2.8 points in the EU, to 69.3 and 66.7 respectively. The Commission believes that this month's increase is due mainly from a clear improvement in sentiment in the retail sector. The euro area Business Climate Index (BCI) rose in May to -3.17, from -3.26 in April. The indicator remains nevertheless at a very low level, and the Commission's indication is that y-o-y industrial production growth will likely be negative in April and will remain distinctly subdued in May.

German Ifo rises for second month in a row:

¶13. (SBU) The German Ifo index also rose for the second time in a row, to 84.2 in May from 83.7 in April, reaching the highest level since November 2008. However, the increase fell short of what experts had expected.

DAVIS